

July 2010

# DEFENSE INFRASTRUCTURE

## Army's Privatized Lodging Program Could Benefit from More Effective Planning



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Highlights of [GAO-10-771](#), a report to congressional committees

## Why GAO Did This Study

The Department of Defense (DOD) operates nearly 70,000 lodging rooms—similar to hotel rooms—and spent nearly \$1 billion in 2009 to operate them. In 2002, Congress provided authority to privatize lodging facilities. Army privatized lodging at 10 installations in August 2009 and plans to privatize its remaining domestic facilities in the future. The National Defense Authorization Act for Fiscal Year 2008 requires GAO to review lodging privatization and an Army report. This report addresses (1) the factors the military services considered in their decisions to privatize, (2) challenges in the Army's privatization efforts, (3) the effect of the economic downturn on the Army's privatization program, and (4) the extent to which an Army report required by the act, issued in March 2010, addresses the elements in the law. GAO reviewed documentation and interviewed officials from the Office of the Secretary of Defense, the military services, the developer for the Army's privatization project, and four Army installations where lodging was privatized.

## What GAO Recommends

GAO recommends that the Army assess the costs and benefits of completing repairs to future facilities to be privatized, develop a transition plan, and clarify how it will incorporate lessons learned into future privatization efforts. In commenting on a draft of this report, DOD agreed with GAO's recommendations and plans to take actions to address them.

[View GAO-10-771](#) or [key components](#).

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## DEFENSE INFRASTRUCTURE

### Army's Privatized Lodging Program Could Benefit from More Effective Planning

#### What GAO Found

The Army decided to privatize its lodging facilities to obtain private sector financing to address the poor condition of its facilities and the high estimated costs to repair them, whereas the other military services decided not to privatize since the services' lodging expenses could increase due to higher room rates if privatized and officials viewed their lodging facilities as in generally good condition. GAO's analysis found that if the military services chose to privatize, lodging costs could increase due to higher room rates.

Army officials GAO interviewed generally viewed the lodging privatization transfer process and improvements the developer has made since the transfer as a success; however some challenges affected the timing of building new facilities and the transition of operations to the private developer. First, the private developer had to delay the start of major renovations and new construction by 2 years given several life-safety and critical system deficiencies at these facilities. The developer is currently repairing these deficiencies at its expense before these conveyed facilities can be used as collateral to obtain further financing to begin the planned renovations and new construction at the Army's 10 installations privatized to date. However, the extent to which similar life-safety and critical system deficiencies repairs for the next group of facilities to be privatized should be completed by the Army or the private developer is unclear because the Army has not fully assessed the costs and benefits of performing these repairs. Second, those involved in privatizing the lodging facilities experienced confusion about some aspects of the transfer of facilities and equipment to the developer because the Army did not develop a single, comprehensive transition plan that included information on all the tasks to be completed as part of the transfer process. Thus, installations encountered some problems, such as transferring data to the developer, and the Army may encounter similar challenges in future lodging privatization efforts.

The economic downturn hindered the private developer's ability to obtain financing for the lodging privatization project at favorable interest rates, which also delayed the project. Specifically, the Army cited the constrained credit environment, the ability to demonstrate sufficient cash flow, and the need to address facility life-safety and critical repair issues before using the facilities as collateral as factors that affected the private developer's ability to obtain long-term financing for the lodging privatization project.

The Army's report addressed the three elements required by the law, but it lacks some information related to one of the elements that could help clarify the Army's responses. The Army's report addressed the elements that the Army evaluate the efficiency of lodging privatization and make recommendations about expanding the program. While the Army's report describes implementation at the privatized installations, as required, it does not describe how it plans to incorporate lessons that the Army identified in the report into future privatization efforts.

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# Contents

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<b>Letter</b>		<b>1</b>
	Background	6
	Cost and Condition of Facilities Were Key Reasons in Military Services' Decisions about Lodging Privatization	9
	Army Officials Viewed Transfer as Successful, but Deficiencies in Army Facilities and Lack of Clarity about Transfer Steps Affected Privatization and May Challenge Future Efforts	14
	Economic Downturn Delayed Privatization for Group A and Could Affect Future Privatization Efforts	20
	Army's Report to Congress Addresses Required Elements, but Lacks Information to Help Clarify One Response	24
	Conclusions	26
	Recommendations for Executive Action	27
	Agency Comments and Our Evaluation	28
<b>Appendix I</b>	<b>Scope and Methodology</b>	<b>30</b>
<b>Appendix II</b>	<b>Comments from the Department of Defense</b>	<b>34</b>
<b>Appendix III</b>	<b>GAO Contact and Staff Acknowledgments</b>	<b>37</b>
<b>Related GAO Products</b>		<b>38</b>
<b>Table</b>		
	Table 1: Estimated Increase in Lodging Expenses Under Privatization Compared to Service-Operated Lodging at Domestic Installations for Fiscal Year 2009	11
<b>Figures</b>		
	Figure 1: Locations of Army Lodging Facilities Privatized in Group A	3
	Figure 2: Time Line of Key Army Lodging Privatization Efforts for Group A Installations	8

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United States Government Accountability Office  
Washington, DC 20548

July 30, 2010

## Congressional Committees

The Department of Defense (DOD) operates nearly 70,000 lodging rooms, similar to commercial hotel rooms, to accommodate authorized travelers across the United States and spent nearly \$1 billion in fiscal year 2009 to operate these facilities. DOD established its lodging program to help maintain mission readiness and improve productivity by providing affordable, quality lodging facilities for authorized travelers. Authorized travelers fall into two categories: temporary duty travelers are primarily military and civilian personnel temporarily traveling on official business and permanent change of station travelers are primarily military personnel and their families who are moving to new duty locations.<sup>1</sup> The Army determined in 2003 that it needed to either replace or renovate about 80 percent of its lodging facilities due to the poor condition of these facilities and needed a plan to sustain and recapitalize the facilities for the long term. The Army determined that privatization, through conveying the facilities and transferring responsibility for the management and maintenance of those facilities to a private developer, would allow it to address the near-term concerns with the condition of the lodging facilities more quickly than under continued Army operation, as well as address the facilities' long-term sustainment and recapitalization needs.

In 1996, Congress enacted the Military Housing Privatization Initiative authority,<sup>2</sup> which allowed DOD to privatize its family housing, and, in 2002, that authority was expanded to specifically include transient housing, intended to be occupied by members of the armed forces on temporary duty, also known as lodging facilities.<sup>3</sup> This act provided DOD with a variety of authorities to obtain private sector financing and management to operate, repair, and construct lodging facilities. As part of the National

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<sup>1</sup>The services also operate recreational lodging, lodging used by individuals visiting patients in military treatment facilities, and lodging facilities overseas, which are not addressed in this report given they are not part of the Army's lodging privatization program.

<sup>2</sup>National Defense Authorization Act for Fiscal Year 1996 Pub. L. No. 104-106 § 2801 (1996) (codified as amended at 10 U.S.C. §§ 2871-2885).

<sup>3</sup>Bob Stump National Defense Authorization Act for Fiscal Year 2003, Pub. L. No. 107-314 §2803 (2002).

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Defense Authorization Act for Fiscal Year 2008,<sup>4</sup> Congress limited lodging privatization to 13 Army installations, referred to as group A, until 120 days after the Army issued a report on lodging privatization, as required by the same provision.<sup>5</sup> The Army privatized lodging facilities at 10 of these 13 installations in August 2009 under the terms of a 50-year lease with the selected developer.<sup>6</sup> (See fig. 1.) Through this arrangement, the Army retains ownership of the land but conveys ownership of the buildings to the private developer. At the end of the lease term, the buildings, along with any improvements, return to the Army. The private developer plans to complete group A's needed renovations and new construction in three separate phases over the next 8 years—from 2010 through 2017—and maintain the facilities through the 50-year lease term. After the statutory limitation on locations that can be privatized expires, the Army plans to privatize the lodging facilities at its remaining domestic installations in two groups, referred to as groups B and C.

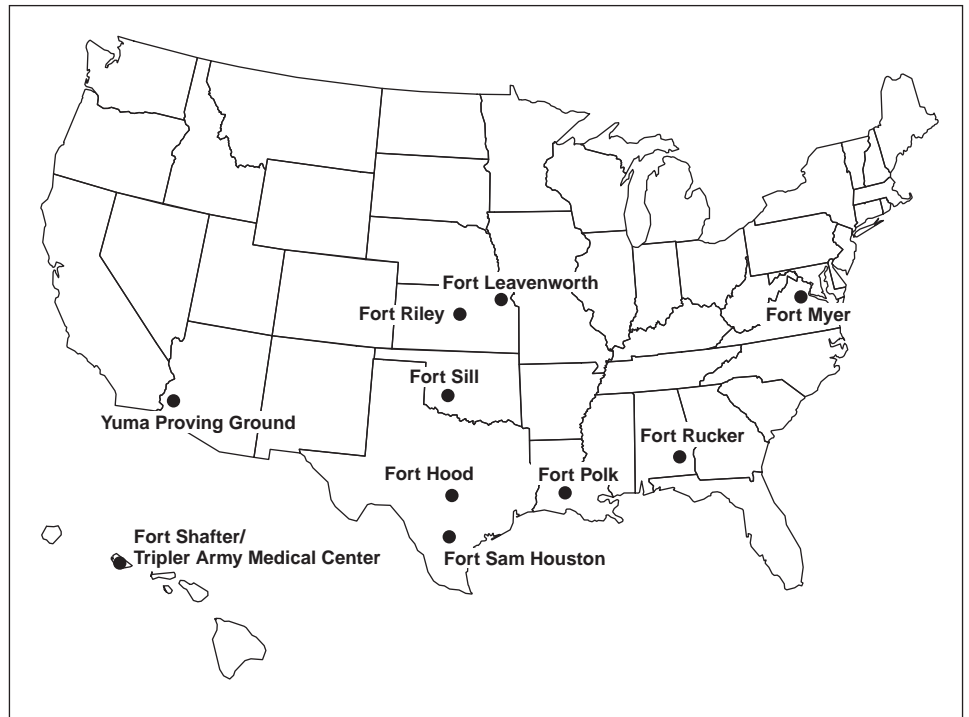
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<sup>4</sup>National Defense Authorization Act for Fiscal Year 2008, Pub. L. No. 110-181 § 2808 (2008).

<sup>5</sup>The 13 installations Congress authorized for privatization, referred to by the Army as "group A," are: Redstone Arsenal, Alabama; Fort Rucker, Alabama; Yuma Proving Ground, Arizona; Fort McNair, District of Columbia.; Fort Shafter, Hawaii; Tripler Army Medical Center, Hawaii; Fort Leavenworth, Kansas; Fort Riley, Kansas; Fort Polk, Louisiana; Fort Sill, Oklahoma; Fort Hood, Texas; Fort Sam Houston, Texas; and Fort Myer, Virginia.

<sup>6</sup>Although Congress authorized privatization of 13 installations, the Army reports that it privatized lodging facilities at 10 installations. First, the Army counted the lodging at Fort Shafter and Tripler Army Medical Center as one location given the close proximity of the locations to each other. Second, the private developer determined that the lodging at Fort McNair was not needed since travelers to the installation generally were traveling to nearby Fort Myer and, therefore, decided to construct additional rooms at Fort Myer instead. The lodging facility at Fort McNair was not conveyed to the developer and the installation plans to convert the facility into administrative space. Third, the Army deferred lodging privatization at Redstone Arsenal for several reasons, including questions about the number of rooms needed at the installation after some training activities are realigned to another installation.

**Figure 1: Locations of Army Lodging Facilities Privatized in Group A**



Sources: Army; Map, Map Resources.

DOD travel regulations generally require that military travelers ordered to military installations stay in government lodging, if available, if they wish to receive full reimbursement of their lodging expense. DOD civilian travelers are not generally required to use government lodging and are not subject to a limitation of their reimbursement based on the cost of the government lodging. DOD civilian travelers are, however, encouraged to use service-operated lodging when available. After lodging is privatized, it will no longer be considered government lodging and will not be subject to availability requirements under travel regulations. As a result, if no other government lodging is available on the installation, travelers can choose to stay either in the privatized lodging on-base—in which room rates are limited to a weighted average of 75 percent of the local per diem rate



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established by the General Services Administration—or in a commercial hotel in the community.<sup>7</sup>

In addition to authorizing privatization of the group A installations, the National Defense Authorization Act for Fiscal Year 2008<sup>8</sup> requires the Army to submit a report to the congressional defense committees describing the implementation of lodging privatization under section 2808 of the act, evaluating the efficiency of the lodging privatization program, and containing its recommendations regarding expansion of the program. The Army issued its report in March 2010.<sup>9</sup> The act also requires that GAO review privatization of temporary lodging facilities and the Army's report. Our report addresses (1) the factors that the military services considered in their decisions whether to privatize their lodging facilities, including the potential cost of privatizing; (2) challenges that the Army encountered in privatizing their lodging facilities; (3) the effect of the economic downturn on the Army's privatization efforts; and (4) the extent to which the Army report addresses the required elements in the law.

To determine the factors that the military services considered in their decisions whether to privatize lodging facilities, including cost impact, we reviewed various documents related to lodging privatization efforts, including reports to Congress.<sup>10</sup> Additionally, we interviewed officials responsible for operating the lodging programs from the four military services, the Office of the Assistant Secretary of the Army (Installations and Environment), the Office of the Under Secretary of Defense (Acquisition, Technology and Logistics), and the Office of the Under Secretary of Defense (Personnel and Readiness). We also calculated the estimated cost impact of privatization using the services' fiscal year 2009 data on the number of days that authorized travelers stayed in service-operated lodging and the average daily rate charged for rooms. Our analysis provides a range of cost estimates depending on whether the

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<sup>7</sup>Per diem rates for locations outside of the continental United States, to include Alaska and Hawaii, are set by the Department of State.

<sup>8</sup>National Defense Authorization Act for Fiscal Year 2008, Pub. L. No. 110-181 § 2808 (2008).

<sup>9</sup>Assistant Secretary of the Army (Installations and Environment), *Privatization of Army Lodging (PAL) Group A Report to Congress* (Washington, D.C.: Mar. 12, 2010).

<sup>10</sup>Assistant Secretary of the Army (Installations and Environment), *Privatization of Army Lodging (PAL) Group A Report to Congress* (Washington, D.C.: Mar. 12, 2010) and U.S. Army, *Report to Congress Regarding Management of Army Lodging* (Washington, D.C.: Feb. 25, 2008).

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traveler stayed in privatized lodging or in a commercial hotel in the community. To determine the challenges that the Army encountered in privatizing lodging facilities, we interviewed officials from the services and the Office of the Secretary of Defense, a representative of the private developer for group A, and four installations that were privatized as part of group A— Yuma Proving Ground, Arizona; Fort Leavenworth, Kansas; Fort Sam Houston, Texas; and Fort Myer, Virginia. We selected these four installations given their location, amount of revenue generated, and the amount of planned renovation compared to new construction, among other factors that could affect the installations' experiences with privatization. We also reviewed the Army's 2010 report to Congress, the Army's Lodging Standards Status Reports, and previous GAO reports on military privatization efforts, including our prior report on lodging privatization and family housing privatization,<sup>11</sup> to identify and assess challenges. To determine the effect of the economic downturn on the Army's privatization program, we reviewed various documents such as the Army's 2010 report to Congress, the private developer's Lodging Development and Management Plan, and the lease agreement between the Army and the private developer to determine changes to the planned scope of the privatization project. Additionally, we interviewed officials from the Office of the Assistant Secretary of the Army (Installations and Environment) and the private developer for group A to obtain their perspectives on economic impact. To determine the extent to which the Army's report to Congress addresses the required elements in the law, we examined whether the Army's report provided the required information. For each element, we also reviewed previous GAO reports to identify best practices that allowed us to assess whether there was additional information that could have helped clarify the Army's responses. Additionally, we spoke with officials from the Army's Family Morale, Welfare, and Recreation Command; Office of the Assistant Chief of Staff for Installation Management; four installations that were privatized as part of group A; and a representative from the private developer for group A to better understand how issues raised in the Army's report affected the lodging privatization program. We also discussed our findings with officials in the Office of the Assistant Secretary of the Army (Installations and Environment), the organization tasked with drafting the

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<sup>11</sup>GAO, *Military Housing Privatization: DOD Faces New Challenges Due to Significant Growth at Some Installations and Recent Turmoil in the Financial Markets*, [GAO-09-352](#) (Washington, D.C.: May 15, 2009) and *Defense Infrastructure: Continuing Challenges in Managing DOD Lodging Programs as Army Moves to Privatize Its Program*, [GAO-07-164](#) (Washington, D.C.: Dec. 15, 2006).

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report. Further details on our scope and methodology are included in appendix I.

We began this performance audit in August 2008; however, we suspended the review in March 2009 given that the Army delayed the release of its report until March 2010, at which time we reinstated our review. We completed our review in July 2010. This review was performed in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

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## Background

Several organizations are involved in implementing and overseeing the Army's lodging privatization efforts. Within the Office of the Secretary of Defense, the Principal Deputy Under Secretary of Defense (Personnel and Readiness) is required to provide guidance, oversight, and procedures to ensure proper administration and management of the DOD lodging programs and monitor compliance with DOD procedures and guidance.<sup>12</sup> The Office of the Under Secretary of Defense (Acquisition, Technology and Logistics), in coordination with the Office of the Under Secretary of Defense (Personnel and Readiness), is required to provide oversight of all lodging privatization undertaken by the DOD components, from feasibility planning through the entirety of the lease term and is responsible for developing privatized lodging performance standards and measures.<sup>13</sup> Within the Army, four organizations are involved in implementing and overseeing lodging privatization. The Family Morale, Welfare, and Recreation Command, within the Installation Management Command, oversees the operation of the service-operated lodging. The Capital Ventures Division within the Office of the Assistant Secretary of the Army (Installations and Environment) negotiates the lease and any changes to the lease with the developer and approves all major decisions. The Public/Private Initiatives Division within the Office of the Assistant Chief of Staff for Installation Management, in coordination with the U.S. Army Corps of Engineers, oversees the privatization projects after privatization

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<sup>12</sup>Department of Defense Instruction 1015.11, *Lodging Policy*, Section 5.1.2 (Oct. 6, 2006).

<sup>13</sup>Office of the Under Secretary of Defense for Personnel and Readiness Memorandum, *DOD Lodging Program* (Apr. 26, 2007).

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and validates the private developer's compliance with the lease. Additionally, lodging employees at the installations play a key role in completing the tasks to transfer facilities and equipment from the Army to the private developer.

As we have previously reported, each of the military services takes its own approach to managing and funding its service-operated lodging program.<sup>14</sup> The Army and Air Force each manages its lodging under a single organization, while the Navy and Marine Corps each have separate organizations to manage temporary duty and permanent change of station lodging. The services' lodging programs are funded with a combination of appropriated funds and nonappropriated funds. Appropriated funds are those monies that Congress provides through the annual appropriations process. These funds are typically used for operation and maintenance expenses, such as utilities, and some kinds of minor construction. Nonappropriated funds are cash and other assets received from sources other than monies appropriated by Congress. Nonappropriated funds are generated at the lodging facilities as revenues through room sales that the traveler pays for the room charge.<sup>15</sup> These funds are used for all expenses that are not paid for with appropriated funds. Each of the lodging programs sets rates according to the amount of revenue needed to pay for expenses not covered by appropriated funds. Those programs that rely largely on nonappropriated funding tend to have higher room rates to cover program expenses, while those that receive more appropriated funds can charge lower room rates.

The Army's lodging privatization process, from its decision to privatize its lodging facilities through transferring the first facilities to the private developer, lasted more than 5 years. Figure 2 shows the key steps in the Army's lodging privatization efforts for group A.

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<sup>14</sup>[GAO-07-164](#).

<sup>15</sup>Because nonappropriated funds are generated primarily through room sales and most of the travelers at the lodges are on authorized travel, most of the nonappropriated funds actually originate from appropriated funds given that reimbursement for official authorized travel expenses are funded from the operation and maintenance or military personnel appropriations.

**Figure 2: Time Line of Key Army Lodging Privatization Efforts for Group A Installations**

2004	2005	2006	2007	2008	2009
<b>April 2004</b> Army decides to privatize its lodging facilities.	<b>October 2005</b> Army issues Request for Qualifications from private developers to begin selection process.	<b>September 2006</b> Army selects private real estate developer Actus Lend Lease to create a lodging development and management plan.		<b>March 2008</b> Army approves the private developer's plan.	<b>August 2009</b> Army conveys facilities at group A installations to developer, developer begins to operate privatized facilities.

Source: GAO analysis of Army information.

The Army decided to privatize its lodging facilities in April 2004, modeling its program after its family housing privatization program. The Army issued a request for qualifications for private developers for the first group of installations in October 2005 and selected Actus Lend Lease as the private developer to create a development plan almost a year later. In March 2008, the Army approved the private developer's plan. In August 2009, the Army conveyed about 3,200 rooms at the 10 group A installations to the private developer and the developer—Actus Lend Lease—and the hotel operator—InterContinental Hotels Group—started managing and operating the privatized lodging facilities.

The developer plans to construct more than 2,000 new rooms and renovate more than 2,100 existing rooms for a total of nearly 4,200 rooms. These renovations and construction are scheduled to occur in three phases over the next 8 years, from 2010 through 2017. The developer plans to build new facilities to meet the standards of InterContinental Hotels' extended stay hotel brands—Candlewood Suites and Staybridge Suites—and renovate some existing facilities to meet the standards for the Holiday Inn Express brand. Hotel operators establish standards for features, such as room sizes and amenities, associated with each brand of the hotel chain. According to the Army's 2010 report to Congress, the use of nationally-recognized brands at the privatized hotels will help ensure the

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implementation of best practices from the hospitality industry, standardized levels of guest service, and the maintenance of facility conditions.<sup>16</sup> In the early phases of the project, the developer plans to operate some facilities conveyed by the Army with limited renovations in order to generate income until the developer can obtain additional funding to continue with large-scale renovations and the construction of new facilities. As new facilities are completed, the developer will either demolish the facilities that it does not plan to retain in its inventory or it will return them to the Army and the Army will decide how to use these returned facilities, such as converting them into barracks or administrative space or demolishing the facilities.

DOD reports its progress on projects privatized under the Military Housing Privatization Initiative authority in semiannual reports to the congressional defense committees. Traditionally, DOD's report provides information on government costs, use of government authorities, program performance, and tenant satisfaction, among other information for its family housing projects. The Army plans to include the same type of information about its lodging privatization project in future reports to Congress.

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## Cost and Condition of Facilities Were Key Reasons in Military Services' Decisions about Lodging Privatization

The Army decided to privatize its lodging facilities to obtain private sector financing to address the poor physical condition of these facilities while under the Army's control and management and the high estimated cost to repair them. Conversely, the other military services had decided not to privatize at the time of our review due to concerns about potential increases in lodging expenses due to increased room rates through privatization and their view that their lodging facilities are in generally good physical condition.

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## Army Decided to Privatize Lodging Facilities Due to the Poor Facility Conditions and the High Cost to Renovate Them

The Army decided to privatize its lodging facilities to obtain private sector financing to address the poor condition of the facilities and the high cost to repair or renovate them. In 2003, the Army reviewed the condition of its lodging facilities and determined that over 80 percent of its facilities were in need of either replacement or renovation. The Army determined that it would cost more than \$1.8 billion to improve facility conditions and

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<sup>16</sup> Assistant Secretary of the Army (Installations and Environment), *Privatization of Army Lodging (PAL) Group A Report to Congress* (Washington, D.C.: Mar. 12, 2010).

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planned to fund these improvements by an additional surcharge on each night that travelers stayed in Army lodging. However, the Army determined that implementing its plan would require more than 20 years to complete all of the identified projects based on the rate that the Army decided to fund the improvements. Further, the Army's plan only addressed the facility needs at the time of the review and did not include renovations or replacements to address future deficiencies or a long-term strategy to sustain the facilities.

According to Army lodging privatization reports to Congress in 2008 and 2010, Army leadership deemed the length of time of the Army's plan to improve the facility conditions and the lack of a long-term sustainment strategy unacceptable and determined that privatization, modeled after the Army's family housing privatization program, would provide private sector resources to redevelop and sustain the facilities to address current and future needs.<sup>17</sup> According to Army officials, transferring the responsibility to address deficiencies in the lodging facilities to a private developer would enable improvements to be made more quickly than if the Army retained the facilities—8 years for the private developer instead of 20 years that the Army estimated it would take. Additionally, the private developer would be expected to maintain these facilities in good condition throughout the 50-year term of the lease. Army officials told us that the Army has not fully maintained many of its lodging facilities in good condition due to constrained funding stemming from other competing priorities.

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**Other Services Have Not Privatized Lodging Facilities Due to Potential Lodging Expense Increases and Relatively Good Quality Buildings**

The Navy, Marine Corps, and Air Force are currently not planning to privatize their lodging facilities given officials' concerns about the potential for increased lodging expenses under privatization due to higher room rates and, in their view, their facilities are in good condition. Based on our analysis of the services' data for fiscal year 2009, the amount that the Navy, Marine Corps, and Air Force are spending on lodging expenses could significantly increase over service-operated lodging if the services chose to privatize and used the Army's approach of charging a weighted average of 75 percent of the local per diem rate for rooms. Based on our analysis, the Army could also experience increased lodging expenses

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<sup>17</sup> Assistant Secretary of the Army (Installations and Environment), *Privatization of Army Lodging (PAL) Group A Report to Congress* (Washington, D.C.: Mar. 12, 2010) and U.S. Army, *Report to Congress Regarding Management of Army Lodging* (Washington, D.C.: Feb. 25, 2008).

under privatization—about 60 percent if all travelers stayed in privatized lodging to about 115 percent if all travelers stayed in commercial sector lodging and paid the full per diem rate. According to Army officials and its 2008 report to Congress, senior Army officials were aware of the potential cost increase when they decided to privatize and determined that some increase in lodging expenses was acceptable given the increase was designed to fund new construction, renovations, and the long-term sustainment of facilities.<sup>18</sup> Our analysis provides a range for the lodging expense increases since, after privatization, travelers can choose to either stay in the privatized facility at 75 percent of the local per diem rate or stay in a commercial hotel in the community at up to the full per diem rate, if no other government lodging is available. Table 1 shows our analysis of the estimated lodging expense increases due to increased room rates for each service if they chose to privatize, compared to continued service-operated lodging.

**Table 1: Estimated Increase in Lodging Expenses Under Privatization Compared to Service-Operated Lodging at Domestic Installations for Fiscal Year 2009**

Military service	Estimated lodging expenses for travelers to domestic service-operated lodging	Net estimated increase in lodging expenses at 100 percent of local per diem rate <sup>a</sup>		Net estimated increase in lodging expenses at 75 percent of local per diem rate <sup>b</sup>	
	Dollars (in millions)	Dollars (in millions)	Percentage increase	Dollars (in millions)	Percentage increase
Navy	\$170	\$380	227%	\$240	143%
Air Force	210	340	160	190	87
Army	130	150	115	80	61
Marine Corps	20	60	260	30	149

Source: GAO analysis of DOD data.

Note: Dollars rounded to nearest \$10 million.

<sup>a</sup>The net estimated increase in lodging expenses at 100 percent of the local per diem rate assumes that all of the travelers who stayed in service-operated lodging in fiscal year 2009 chose to stay in a commercial hotel at the full local per diem rate. We reduced the total estimated increase by the amount of appropriated funds directly spent on the service-operated lodging facilities for fiscal year 2009 given that the costs to operate the lodging facilities would no longer be incurred if the services privatized their lodging facilities, providing an estimated net increase in travel costs. This estimate does not include all appropriated funds that the service spent to support the lodging program, such as for expenses—like utilities, maintenance provided by the installation, and some employees—that are not captured by the services or reported to the Office of the Secretary of Defense.

<sup>18</sup>U.S. Army, *Report to Congress Regarding Management of Army Lodging* (Washington, D.C.: Feb. 25, 2008).



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<sup>b</sup>The net estimated increase in lodging expenses at 75 percent of the local per diem rate assumes that all of the travelers who stayed in the service-operated lodging in fiscal year 2009 stayed at the hypothetically privatized facility and the Navy, Marine Corps, and Air Force followed the Army's privatization approach and charged an average of 75 percent of the local per diem rate. We reduced the total estimated increase by the amount of appropriated funds directly spent on the service-operated lodging facilities for fiscal year 2009 given that the costs to operate the lodging facilities would no longer be incurred if the services privatized their lodging facilities, providing an estimated net increase in travel costs. This estimate does not include all appropriated funds that the service spent to support the lodging program, such as for expenses—like utilities, maintenance provided by the installation, and some employees—that are not captured by the services or reported to the Office of the Secretary of Defense.

While lodging expenses may increase under privatization due to higher room rates, some factors could offset these increases, potentially making the actual increase in lodging expenses less than is shown in our estimates. First, if the military services choose to privatize their lodging facilities, the net increase in lodging expenses may be less than our estimate shows because the services are spending more appropriated funding to support their lodging facilities than they report to the Office of the Secretary of Defense. We reduced the estimated lodging expense increases in our analysis by the amount of appropriated funding that the military services reported spending to the Office Secretary of Defense in fiscal year 2009 given that the costs to operate the lodging facilities would no longer be incurred if the services privatized their lodging facilities. However, as we reported in 2006, some support services, such as utilities, maintenance provided by the installation, or laundry services that are contracted out, are paid for by the installation and these costs are not tracked by program.<sup>19</sup> The owner of a privatized facility would reimburse the installation for these services, thus reducing the net increase to lodging expenses. Service officials said that capturing the full cost of operating lodging facilities remains difficult since the installations do not report this information to the service headquarters. Second, some service officials noted that the services may not be spending as much as is needed to recapitalize and sustain the lodging facilities. Lodging privatization is intended to fully fund maintenance and renovations and, thus, may appear to cost more than service-operated lodging given that the military services are not fully funding maintenance and renovations of existing facilities.

Additionally, the Navy, Marine Corps, and Air Force officials told us that they are currently not planning to privatize their lodging facilities is that the services viewed their facilities as being in relatively good physical condition. Officials from these three services said that they have generally

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<sup>19</sup> [GAO-07-164](#).

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been able to meet maintenance and renovation needs and, therefore, did not need to obtain private sector resources through privatization to improve the condition of the lodging facilities. However, officials expressed concerns about their ability to meet some maintenance and renovation needs in the future. For example, Navy officials said that more than 25 percent of the lodging facilities for temporary duty travelers are more than 48 years old, and some of the buildings are more than 60 years old. These officials noted that the Navy needs to determine how it will meet long-term recapitalization needs of these facilities before they become inadequate. Additionally, Marine Corps officials said that their lodging facilities for temporary duty travelers are also getting older and will require more funding to meet the facilities' maintenance and renovation needs; however, Marine Corps officials told us they spend limited funding to meet these needs given the competing demands for appropriated funding and that lodging is often a lower priority for the installations. Moreover, the Marine Corps has recently focused on renovating and replacing its housing for unaccompanied personnel, which officials expected would further limit the funding available for new construction or major renovations at the lodging facilities. Also expressing concern about their ability to fund future needs, an Air Force official said that the Air Force needed to spend millions of dollars renovating its temporary lodging facilities, including replacing outdated electrical, plumbing, and heating systems at some of its facilities. However, the official noted that there are many unmet needs given competing priorities for appropriated funding for such purposes.

Although the Navy, Marine Corps, and Air Force are currently not planning to privatize their lodging facilities, officials from these three services said that they are observing the Army's efforts and might consider lodging privatization in the future. Specifically, officials from the military services told us that if the Army's program showed that it could improve lodging operations overall by providing quality, cost-effective accommodations, then the services would consider privatizing their lodging facilities.

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## Army Officials Viewed Transfer as Successful, but Deficiencies in Army Facilities and Lack of Clarity about Transfer Steps Affected Privatization and May Challenge Future Efforts

Army officials we interviewed generally viewed the lodging privatization transfer process at the Army's group A installations and improvements the developer has made at the privatized facilities since the transfer as a success. However, some challenges, including deficiencies in life-safety and other critical systems at some group A installations and a lack of clarity among key stakeholders regarding some aspects of the transfer process, affected the planned timing of building new facilities and the efficiency of operations and may pose challenges for future privatization efforts.

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## Army Officials Viewed Transfer as Successful

Army officials we interviewed generally viewed the process to transfer the facilities to the private developer and the improvements that the developer has made since then as successful. Army officials said that the installations encountered some problems during the process to transfer the lodging facilities to the private developer, as discussed below, but they viewed the process as successful given that the facilities were conveyed to the developer with minimal disruptions. Additionally, Army officials said that the developer has made a number of improvements to the lodging facilities since taking over management and operation of the facilities. For example, in October and November 2009, the developer contracted with local cleaning services to address complaints regarding the cleanliness of rooms. Additionally, in November and December 2009, the developer enhanced lobby areas, addressed the maintenance backlog, and made improvements to the landscaping around the facilities, among other improvements. Some installation officials told us that these enhancements improved the quality of the facilities for travelers.

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## Life-Safety and Other Critical System Deficiencies

Many facilities that the Army conveyed to the developer exhibited deficiencies in the life-safety systems, such as fire alarms and sprinkler systems, and other critical systems, such as elevator systems, air conditioning units, and telecommunications systems. These deficiencies occurred in two areas. First, the developer found that some systems did not meet current life-safety or other construction codes. Army officials told us that buildings are generally required to meet Army standards applicable at the time of construction or major renovation. Many of the

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Army's lodging facilities are old and were constructed before modern fire and safety codes were enacted, so some facilities are lacking systems required by more modern codes. For example, at least one lodging facility at Fort Sam Houston, Texas, did not have a fire sprinkler system when the building was conveyed to the developer. According to installation officials, the private developer hired a "fire guard" to serve as a watch-person to alert officials in the event of a fire. Second, the developer found that some systems did not function properly when the Army conveyed the facilities to the developer. For example, the developer and installation officials tested fire alarm systems at each of the group A facilities 2 weeks prior to the transfer and discovered that some alarms malfunctioned.

The Army has made limited investments in its lodging facilities since it decided to privatize the facilities. Since 2005, the Army's Financial Management Operating Guidance has authorized all group A installations to make repairs only when the failure of a component may cause a shutdown, or cause a major disruption of the lodging activity's ability to provide services as required by the Army Lodging Standards. The guidance did not authorize maintenance and repairs executed solely to extend the original useful life of the asset or purchases of new assets other than replacements due to failure.<sup>20</sup> An Army official responsible for overseeing Army-operated lodging explained that in some situations, the Army decided not to replace some systems that were at the end of their expected life cycle given the systems were still functional and the Army delayed replacement to save money. Several officials told us that they believe that the Army should not make substantial repairs to facilities that the Army plans to convey to a private developer given that the Army decided to privatize due to the poor condition of the facilities. The officials expected that a developer, through its due diligence process, would have been aware of the condition of the facilities and the financial risks associated with the project and the Army should not address deficiencies for the developer.

Army officials at two of the four installations we contacted told us that limiting funds to sustain and recapitalize lodging facilities affected the quality of some facilities while the Army was still operating them. For example, officials at Fort Leavenworth, Kansas—which is the home of a

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<sup>20</sup> Army Fiscal Year 2010 Nonappropriated Fund Instrumentalities Financial Management Operating Guidance, Enclosure 6 (Oct. 29, 2009). Similar guidance is included in the operating guidance for previous years.

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number of Army training courses—told us that their internet capabilities were scheduled to be upgraded shortly after the decision to privatize lodging on the installation was announced. However, the Army did not upgrade the system since it was going to be conveyed to the developer. According to the officials, this caused significant problems for the students staying at the facilities, many of whom needed internet access for their coursework. The officials said that the private developer upgraded the internet system shortly after taking responsibility for the property. Further, officials at Fort Leavenworth said that the installation had a staggered 5-year replacement cycle in which the furnishings, such as carpet and mattresses, in 20 percent of the rooms were replaced each year. However, such replacements were limited by the Army guidance and none of these replacements have occurred in the past 5 years. Additionally, an official at Yuma Proving Ground, Arizona, told us that the lodging facility's air conditioning system needed replacement prior to the transfer; however, such replacement was not allowed. According to the official, it would have benefited the Army to replace the system since it would have increased the quality of the facility for Army travelers who still used the facility while it was operated by the Army. Further, the developer plans to operate that facility only until it constructs a new hotel on the installation in a few years and, at that time, the developer will return the facility to the Army. Also, Army officials, including officials at two of the four installations with whom we spoke, as well as officials from the Office of the Secretary of Defense, questioned the Army's decision to stop funding recapitalization at the lodging facilities since the lack of funding led to some deficiencies that negatively affected travelers. Due to the Army's limited investment in its lodging facilities in recent years, the private developer had to include an additional phase to the planned project to address life-safety and critical system deficiencies before the lender would accept the conveyed facilities as collateral to finance future renovations and new construction. Thus, planned major renovations and new construction will be delayed until the private developer can complete the needed life-safety and critical system repairs, which will take about 2 years, according to Army officials.

Limited investment in the existing Army-operated lodging facilities may pose similar challenges for future privatization efforts. Many of the lodging facilities remaining in the Army's inventory are over 50 years old and likely have similar problems with life-safety and critical systems identified at the group A installations. The Army's Family Morale, Welfare, and Recreation Command instructed the Directorate of Public Works on each installation expected to be privatized in the next group to conduct Army Lodging facility evaluations to determine if the buildings meet life-safety standards,

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if the building systems are functioning correctly, and to identify any hazardous materials. They were also to include estimates for repair or replacement when it was determined feasible to install life-safety systems in each building. As of May 2010, the installations identified about \$45 million in repairs—about \$37 million to address life-safety and critical systems problems, such as asbestos and lead paint removal and repairs to fire prevention and detection systems and about \$8 million to repair furniture and fixtures in guest rooms and waiting areas. In comparison, the private developer is planning to spend \$64 million to address life-safety and critical system deficiencies at group A installations. An Army official told us that the installation-provided estimates are lower than the official expected and may not provide a complete picture of the condition of the facilities and the needed repairs. According to Army officials, the Army plans to raise room rates—which are generally paid for with appropriated funds for authorized travelers—at installations in the next group to be privatized to generate revenue to address the deficiencies that the installations identified.

We have previously reported that assessing the costs and benefits of investments is important since such analyses help decision makers determine the best way to meet the needs of the program with the resources available, as well as inform the best path forward.<sup>21</sup> Additionally, we have reported that assessing the costs and benefits of alternative approaches could help an agency more fully ensure that it is efficiently allocating and prioritizing its resources.<sup>22</sup> However, the extent to which the repairs that the Army identified to address deficiencies in the life-safety and critical systems for the next group of installations to be privatized should be completed by the Army or the private developer is unclear because the Army has not fully assessed the costs and benefits of performing these repairs. For example, in weighing the Army's goal to provide for timely construction of on-post lodging facilities against the Army's decision to privatize due to the cost and time needed to complete the repairs, the Army may decide that some of the repairs should be completed by the Army, while other repairs should be completed by the

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<sup>21</sup>GAO, *Aviation Security: TSA Is Increasing Procurement and Deployment of the Advanced Imaging Technology, but Challenges to this Effort and Other Areas of Aviation Security Remain*, [GAO-10-484T](#) (Washington: D.C.: Mar. 17, 2010).

<sup>22</sup>GAO, *Supply Chain Security: Feasibility and Cost-Benefit Analysis Would Assist DHS and Congress in Assessing and Implementing the Requirement to Scan 100 Percent of U.S.-Bound Containers*, [GAO-10-12](#) (Washington, D.C.: Oct. 30, 2009).

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developer. Facilities that are expected to be returned to the Army after the private developer builds a new facility would be an example in which the Army's cost-benefit assessment could aid decision makers in determining the best way to meet the needs of the program with the resources available. Without an assessment of the costs and benefits of the Army completing these repairs, the Army may not be spending its financial resources as efficiently as possible and fully assessing whether the costs of completing the repairs outweigh the benefits.

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### Lack of Clarity Concerning the Transfer Process

A second challenge that affected privatization at the Army's 10 group A installations is that key stakeholders involved in transferring facilities and property from the Army to the private developer experienced confusion and a lack of clarity about the transfer process. For example, installation officials told us that it was unclear what information to provide to employees who worked at the Army lodging facilities about retaining their jobs. Thus, some experienced employees who did not want to work for the private developer accepted other employment, taking their knowledge of lodging operations with them and causing staffing shortages. Additionally, installation officials told us that it was not clear what was expected of employees during the transition, such as the information to provide in response to guest questions about privatization in the time leading up to the transfer. Officials at one installation noted the importance of training all lodging employees on what is expected of them during the transfer and emphasized that this should include those employees who are not taking jobs with the developer after the transfer. Moreover, installation officials and other Army officials stated that lodging employees were not informed that all equipment inside the lodging facilities at the time of the transfer became the property of the private developer. Therefore, some equipment that was shared by multiple morale, welfare, and recreation programs or other organizations on the installation, such as projectors, was transferred to the developer and can no longer be used by the other Army programs. An Army official told us that this includes vehicles that were used by the lodging facilities, even though those vehicles could have been used by other morale, welfare, and recreation programs.

The installation officials we interviewed were relatively satisfied with the amount of information provided in installation-specific briefings by the private developer and the Office of the Assistant Secretary of the Army (Installations and Environment). However, these officials indicated that they were dissatisfied with the lack of information on specific actions needed to facilitate the transfer. The Office of the Assistant Secretary of the Army (Installations and Environment) developed a 37-item checklist

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that officials in that office used to track preparations for the transfer. The checklist included items such as confirming general manager hires and inventorying all furniture, fixtures, and equipment to convey to the developer. However, this checklist was not provided to installations. Additionally, the Family Morale, Welfare, and Recreation Command provided guidance to installations on steps to take starting about 3 months before the transfer to close out the lodging activity and guidance on conducting a financial audit the night before the transfer. In addition to this guidance, the Family Morale, Welfare, and Recreation Command held weekly phone calls to provide information to installation officials. However, installation officials said that this information was provided in several different documents and covered only a small piece of the transfer process and noted that there was no single, comprehensive transition plan that detailed all of the tasks that needed to be completed to facilitate the transfer.

We have previously reported that successful transformations, such as that from service-operated to privatized lodging, are a substantial commitment that must be carefully and closely managed.<sup>23</sup> As we stated in that report, it is essential to establish and track implementation goals—or key steps required to accomplish the transfer—to identify shortfalls and gaps and midcourse corrections. By demonstrating progress towards these goals, the organization builds momentum and helps to ensure the transformation's successful completion. However, because the Army did not develop a single, comprehensive transition plan, group A installations encountered some problems during the transfer. For example, at one installation, guest data were prematurely removed from the Army's system and were not transferred to the developer's system. As a result, all of the guests had to go to the front desk and check-in again, creating frustration. Additionally, some installation officials said that they still have questions related to some aspects of the operation of privatized facilities. For example, officials at one installation told us that they were unsure about the process to change the municipal services agreement—which establishes the terms for the private developer to reimburse the installation for municipal services, such as utilities and police and fire protection—between the installation and private developer, thus adding to the confusion during the transition.

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<sup>23</sup>GAO, *Results-Oriented Cultures: Implementation Steps to Assist Mergers and Organizational Transformations*, [GAO-03-669](#) (Washington, D.C.: July 2, 2003).



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## Economic Downturn Delayed Privatization for Group A and Could Affect Future Privatization Efforts

The recent economic downturn hindered the private developer's ability to obtain financing for the lodging privatization project at favorable interest rates, which delayed privatization at group A installations and may affect future privatization efforts. In its March 2010 report to Congress on lodging privatization, the Army identified three factors related to the economic downturn that affected the private developer's ability to obtain long-term, low-rate financing for the lodging privatization project: (1) the constrained credit environment; (2) the need for proven occupancy while privatized, which would demonstrate sufficient cash flow; and (3) the need to address facility life-safety and critical repair issues before using the facilities as collateral.

- The constrained credit environment affected the private developer's ability to obtain financing for the project and contributed to delays in privatizing the lodging facilities. As we have previously reported, financial markets were in significant turmoil in October 2008, due to the correction in the U.S. housing market.<sup>24</sup> By late summer 2008, the effects of the economic downturn included the failure of financial institutions as a result of increased losses of individual savings and corporate investments and further tightening of the availability of credit through stricter credit standards and increased capital requirements for financial institutions. By fall 2008, the economic downturn further reduced liquidity throughout the capital markets, thereby reducing the amount of funds available for loans while also increasing borrowing costs since the cost of capital can rise as liquidity declines.
- The need for proven occupancy at the privatized facilities affected the developer's ability to obtain financing for the project. In the fall of 2008, as part of the process to obtain financing for the lodging privatization project, credit rating agencies determined the credit risk of the project. Each of the credit rating agencies uses a unique rating to denote the grade and quality of the investments being rated from quality investments to noninvestment or speculative grade investments. Two credit rating agencies reviewing the lodging privatization project initially indicated that an investment grade rating was possible. However, the private developer's formal discussions with two of the rating agencies coincided with the bankruptcy filing of a major financial institution, which led the credit rating agencies to become much more conservative in their ratings. As a result, the agencies rated the

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<sup>24</sup>GAO, *Troubled Assets Relief Program: One Year Later, Actions Are Needed to Address Remaining Transparency and Accountability Challenges*, [GAO-10-16](#) (Washington, D.C.: Oct. 8, 2009).

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lodging privatization project as “below investment grade”—meaning that the agencies rating the bonds determined that the viability of the project posed a greater risk to investors—at a time when the cost of capital was becoming more expensive and lenders were becoming more scarce and selective about projects they were willing to finance. The agencies cited the ability of authorized military travelers to select their hotel of choice if no other government lodging is available—which will be the case on some installations after the facilities are privatized—as an overriding risk factor. Only after receiving information that authorized travelers would still come to the privatized facilities would the agencies consider changing the risk profile and granting the better investment grade ratings. In its March 2010 report to Congress, the Army stated that the project exceeded budgeted occupancy rates in 5 of the first 6 months of operating the privatized facilities. Army lodging officials, including officials at three of the four group A installations with whom we spoke, said the developer should meet or exceed its anticipated occupancy rates as long as the developer continues to coordinate lodging operations with the training schools associated with many installations and maintain quality facilities and a high level of service, thus effectively competing with other hotels in the local market.

- The private developer had to address facility life-safety and critical repair issues before the lender would allow the facilities to be used as collateral for obtaining debt, which in turn, also affected the developer’s ability to obtain long-term, low-rate financing for the privatization project, as we previously discussed. According to an Army official, lenders did not want to take the risk of financing a project that did not meet life, health, and safety codes.

As a result of these three factors, the Army and the private developer decided that the best course of action was to delay privatization for more than 8 months from the planned transfer date in December 2008 to August 2009. Additionally, these three factors led the developer to obtain financing through a 2-year bridge loan—a short-term loan with an agreement for additional long-term financing in the future—with increased borrowing cost, rather than through a bond issuance, which is the traditional financing method for projects privatized under the Military Housing Privatization Initiative authority.

Due to these challenges, the developer was unable to obtain financing for the project as originally planned and—in consultation with the Army—revised the scope of the project by extending the replacement schedule for some facilities and changing the brand associated with the hotel chain for facilities to be built on some installations. First, the private developer

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plans to increase the amount of time it will retain some existing facilities in the lodging inventory. The replacement schedule for some of the facilities in group A has increased by an average of 8 years and as much as 15 years at one facility at Fort Hood. While the effect of the developer's increased reliance on renovated facilities is currently unknown, it could potentially affect the attractiveness of the lodging facilities in relation to some commercial sector hotels located near installations. Second, the developer revised the project scope by changing the brand associated with the hotel chain of some hotels to be constructed. According to the development plan, the private developer originally planned to build all of the new facilities to meet the standards for the lodging operator's upscale extended-stay hotel brand, which offers larger rooms with upgraded fixtures. However, at eight of the nine installations with lodging facilities scheduled for new construction, the developer changed the brand to the hotel chain's midscale extended-stay hotel brand, which offers smaller rooms, does not use upgraded fixtures, and typically charges lower room rates in the commercial sector. Even though the developer saved about \$25 million by building smaller rooms and not using upgraded fixtures at these installations, the change has the potential to make the lodging facilities less attractive to some travelers than some commercial sector hotels in the community. Moreover, the developer diverted resources from renovating facilities to meet brand standards to address life-safety and critical repairs, which slowed the transformation into branded hotels. For example, only 29 percent of the inventory under privatization will be renovated to meet the standards of the hotel chain's brand during the first 24 months of the project. The remaining facilities will be operated without significant renovations—excluding renovations to address life-safety and critical systems—in order to generate income until the developer can obtain additional funding to continue with the large-scale renovations and the construction of the new facilities.

According to Army officials, these changes to the scope of the project decreased the total cost of the project by about \$75 million—or about 15 percent. After about 1 year of the developer operating the privatized facilities, the Army and developer will assess the lodging demands of each installation's lodging operation and jointly finalize the final number of rooms in the project's end state, the ratio of new to renovated rooms, and the brand associated with the hotel chain—to include the corresponding standards and amenities—for each facility, according to the Army's 2010 report.

Uncertainties in the economy still exist and future privatization efforts for group A and subsequent privatization efforts will depend on conditions in

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the credit markets. A representative of the developer told us that liquidity in financial markets has increased since the economic downturn in 2008 and the developer feels that the project can be refinanced at more favorable interest rates than those obtained to make life-safety and critical repairs. Although a representative for the developer and Army officials told us that liquidity in financial and credit markets is improving, uncertainties in the market still exist and future market conditions—which are currently unknown—could affect future privatization efforts. For example, the developer expects to refinance its current debt and obtain additional debt to complete the plans for new construction and renovations at group A facilities. According to the Army’s March 2010 report, the developer plans to use revenues from both newly constructed lodging facilities at four installations and existing privatized facilities in the inventory, as well as provide 24 months of occupancy and performance data to lenders, to refinance the current loans into a more traditional bond structure used in other projects under the Military Housing Privatization Initiative authority. The developer also plans to obtain additional funds by refinancing the current debt to proceed to the second and third phases of the project for facilities in group A.

By their nature, privatization projects usually entail developers assuming a certain level of risk related to the project, including risks that the installation where the project is located could be closed or financial conditions could affect the financial solvency of a developer. According to Army officials, the Army has made no loan guarantees or other explicit guarantees associated with its lodging privatization program and has no plans to negotiate any changes to these agreements at this time. Therefore, as the lease is currently structured, Army officials believe that the government does not have financial liability for the debt held by the developer in the event of a base closure or financial difficulties by the developer.

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## Army's Report to Congress Addresses Required Elements, but Lacks Information to Help Clarify One Response

The Army's report addresses the three elements required by the National Defense Authorization Act for Fiscal Year 2008, which required the Army to (1) describe the implementation of lodging privatization at the installations included in group A, (2) evaluate the efficiency of the lodging privatization program, and (3) include recommendations that the Secretary of the Army considers appropriate regarding expansion of the lodging privatization program.<sup>25</sup> However, the Army report lacks some information related to the first element that could help clarify the Army's responses.

The Army report addressed the second and third elements of the act. To address the second element, which requires the Army to evaluate the efficiency of the program, the Army reported that the private developer's performance met or exceeded expectations on seven developmental, operational, and financial performance measures. For example, the Army reported that the developer began renovation work a month ahead of schedule—in December 2009 rather than January 2010—for the "Construction Progress" performance measure. Similarly, the developer exceeded occupancy projections by about 5 percent for one of the operations performance measures. The Army also reported that the developer exceeded projections of its net operating income—a measure of the developer's ability to manage operating expenses, pay debt service, and fund development—by 40 percent over the first 4 months of the project. These measures are among those that are part of the Army's quarterly review. The Army plans to use performance information to oversee the lodging privatization program and if the Army finds that the private developer's performance is below expectations in any of the performance measures, then the Army plans to review those areas with the private developer to better ensure that the developer is implementing corrective action to minimize the effect on the project performance. According to officials from the Army and the Office of the Secretary of Defense, DOD plans to include lodging privatization performance information in DOD's semiannual reports to Congress on the Military Housing Privatization Initiative starting with the next report, which the Office of the Secretary of Defense expects to provide to Congress in

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<sup>25</sup>National Defense Authorization Act for Fiscal Year 2008, Pub. L. No. 110-181 § 2808 (2008).

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December 2010.<sup>26</sup> The third element requires the Army to make recommendations regarding the expansion of the privatization program. The Army report recommends privatizing lodging facilities at an additional 11 installations, based on the lodging privatization program's performance to date.<sup>27</sup> Additionally, the report states that the Army's goal is to privatize its entire domestic lodging inventory.

The Army report also addressed the first element, but the Army could have provided additional information to help clarify its response. To address the first element, the Army described some challenges that the Army and the private developer experienced from the transfer of the facilities to the private developer through the first 6 months of operating privatized lodging facilities. Some of these challenges include issues with employee transition, particularly due to delays in the transition; issues with the termination of telephone service contracts; the condition of the facilities being worse than the private developer expected; and difficulties in the private developer receiving payments from centralized Army accounts. The Army report includes recommendations for addressing each of the challenges that it identifies in its report. For example, the Army reported that as of December 31, 2009, Army travelers owed the private developer more than \$4.3 million—about 1 month's revenue—with the vast majority from centrally billed Army accounts. The Army report states that the Army, local bill payers, contracting officers, and the hotel operator should work together to review existing processes to look for ways to bring more efficiencies to the payment process and remit payments for hotel bills when due.

However, the Army's report does not describe how the Army plans to address the lessons learned that it identified in the report. We have previously reported on the importance of addressing lessons learned and

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<sup>26</sup>The House Report accompanying the Military Quality of Life and Veterans Affairs, and Related Agencies Appropriations Bill of 2006 directed DOD to report on the status of each Military Housing Privatization Initiative project underway, on a no less than semiannual basis. H.R. Rep. No. 109-95, at 25 (2005).

<sup>27</sup>The 11 installations that the Army recommends for the next group of privatization are Fort Wainwright, Alaska; Fort Huachuca, Arizona; Fort Gordon, Georgia; Fort Campbell, Kentucky; Fort Knox, Kentucky; Fort Leonard Wood, Missouri; White Sands Missile Range, New Mexico; Fort Hamilton, New York; Fort Buchanan, Puerto Rico; Fort Bliss, Texas; and Fort Belvoir, Virginia.

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incorporating corrective actions into ongoing efforts.<sup>28</sup> Although the Army report states that it will incorporate the lessons learned into any subsequent lodging privatization efforts, the report did not explain what the Army would do. Army officials told us they have started to document lessons learned, but do not plan to share them widely until after July 2010—120 days after the Army’s lodging privatization report—due to the limitation in the National Defense Authorization Act for Fiscal Year 2008 on future lodging privatization efforts.<sup>29</sup> Because it is currently unclear how the Army will incorporate lessons learned into its current and future privatization efforts, the Army may miss opportunities to improve management of the privatization process and more effectively implement changes to the lodging privatization program for group A and future groups by key stakeholders, such as the Family Morale, Welfare, and Recreation Command, Office of the Assistant Secretary of Defense (Installations and Environment), and the Office of the Assistant Chief of Staff for Installation Management. We have previously reported that the failure to complete planned corrective actions places agencies at risk of wasting resources on subsequent efforts that repeat problems that would be addressed by lessons learned from previous efforts.<sup>30</sup>

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## Conclusions

The Army is privatizing its lodging facilities in an effort to provide higher quality lodging and services to Army soldiers and their families at a rate faster than it has stated it can do on its own and to sustain and recapitalize those facilities over the long term. While the private developer has met or exceeded the performance goals for the Army’s lodging privatization program over the first 6 months of privatized operations and key stakeholders generally agreed that privatization at group A installations has been successful, the Army lacks some tools to better ensure more efficient program management, thus potentially limiting the success of future lodging privatization efforts. First, without assessing the costs and

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<sup>28</sup>See, for example, GAO, *Critical Infrastructure Protection: DHS Needs to Fully Address Lessons Learned from Its First Cyber Storm Exercise*, [GAO-08-825](#) (Washington, D.C.: Sept. 9, 2008) and *Defense Transportation: DOD Has Taken Actions to Incorporate Lessons Learned in Transforming Its Freight Transportation System*, [GAO-07-675R](#) (Washington, D.C.: May 8, 2007).

<sup>29</sup>The National Defense Authorization Act for Fiscal Year 2008, Pub. L. No. 110-181 § 2808 (2008), limits privatization of lodging facilities to the 13 installations identified in the law until 120 days after the Army’s report to Congress on lodging privatization, which was issued in March 2010.

<sup>30</sup>[GAO-08-825](#).

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benefits of the Army or the developer repairing existing life-safety and critical system deficiencies at installations planned to be privatized in the next group, the Army could be spending its financial resources inefficiently. Second, without a single, comprehensive transition plan that details the key steps needed to transfer lodging facilities from the Army to the private developer, the Army will continue to be in a position of not ensuring more efficient operations of the facilities before, during, and after the transfer of future groups. Finally, by not taking steps to clarify how the Army plans to incorporate lessons learned from the privatization of group A installations, the Army is less likely to realize the benefit of these experiences as it continues its goal of privatizing its entire domestic lodging inventory in the future and risks repeating some of the same challenges as in the first effort to privatize.

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## Recommendations for Executive Action

- (1) To better ensure that the Army is spending its financial resources as efficiently as possible, we recommend that the Secretary of the Army direct the Assistant Chief of Staff for Installation Management and the Commander, Installation Management Command, working with the Assistant Secretary of the Army (Installations and Environment), to assess the costs and benefits of the Army or a private developer repairing life-safety and critical infrastructure deficiencies at facilities in future groups to be privatized.
- (2) To facilitate more efficient operations before, during, and after the transition from service-operated to privatized lodging, we recommend that the Secretary of Army direct the Assistant Secretary of the Army (Installations and Environment), working with the Assistant Chief of Staff for Installation Management and the Commander, Installation Management Command, and other appropriate stakeholders, to develop a single, comprehensive transition plan for future lodging privatization that includes details on key aspects of privatizing.
- (3) To facilitate effective implementation of lessons learned into the lodging privatization program, we recommend that the Secretary of the Army direct the Assistant Secretary of the Army (Installations and Environment); the Assistant Chief of Staff for Installation Management; the Commander, Installation Management Command; and other stakeholders to clarify how the Army will incorporate lessons learned into its current and future privatization efforts.



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## Agency Comments and Our Evaluation

In written comments on a draft of this report, DOD concurred with our three recommendations and indicated planned actions for addressing them. Specifically, in response to our first recommendation to assess the costs and benefits of the Army or a private developer repairing life-safety and critical infrastructure deficiencies at facilities in future groups to be privatized, DOD noted that it will analyze such costs and benefits after the Army assesses compliance with basic fire and life-safety requirements and the condition of the existing infrastructure at facilities at the next 11 installations to be privatized. However, the department also noted that funding to fix these deficiencies is not currently budgeted. In response to our second recommendation to develop a single, comprehensive transition plan for future lodging privatization, the Army plans to develop a single document to consolidate plans, policies, procedures, and time lines related to lodging privatization. In response to our third recommendation to clarify how the Army intends to incorporate lessons learned in its current and future privatization efforts, the department commented that the Army has already started implementing some lessons learned and plans to request feedback from the developer, the hotelier, and all Army stakeholders regarding lessons learned and include the information in the single, comprehensive plan for future privatization efforts. DOD's comments are reprinted in appendix II. DOD also provided technical comments, which we incorporated as appropriate into this report.

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We are sending copies of this report to interested congressional committees; the Secretary of Defense; the secretaries of the Army, Navy, and Air Force; Commandant of the Marine Corps; and the Director, Office of Management and Budget. In addition, the report will be available at no charge on GAO's Web site at <http://www.gao.gov>. GAO staff who made contributions to this report are listed in appendix III.

If you or your staff have any questions concerning this report, please contact me on (202) 512-4523 or by e-mail at [leporeb@gao.gov](mailto:leporeb@gao.gov). Contact points for our Offices of Congressional Relations and Public Affairs are on the last page of this report.



Brian J. Lepore, Director  
Defense Capabilities and Management

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The Honorable Zach Wamp  
Ranking Member  
Subcommittee on Military Construction, Veterans' Affairs, and Related  
Agencies  
Committee on Appropriations  
House of Representatives

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# Appendix I: Scope and Methodology

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We reviewed various documents and interviewed several defense organizations involved with implementing and overseeing the military services' lodging program for temporary duty and permanent change of station travelers. We interviewed officials within the Office of the Under Secretary of Defense (Acquisition, Technology and Logistics) and the Office of the Under Secretary of Defense (Personnel and Readiness) given their roles in providing oversight of all lodging privatization. Furthermore, we interviewed officials from the Army, Navy, Marine Corps, and Air Force offices responsible for operating the service-operated lodging programs to assess program status. However, we focused most of our work on the Army given it is the only military service to have started privatizing lodging. Thus, to better understand the Army's lodging program and its recent efforts to privatize, we contacted (1) the Family Morale, Welfare, and Recreation Command, within the Installation Management Command, that oversees the operation of the service-operated lodging; (2) the Capital Ventures Division within the Office of the Assistant Secretary of the Army (Installations and Environment) that negotiated the lease with the developer and approved major decisions involving the privatization program; and (3) the Public/Private Initiatives Division within the Office of the Assistant Chief of Staff for Installation Management that provides oversight of the privatized projects after privatization.

To determine the factors that the military services considered in their decisions whether to privatize their lodging facilities, we mostly focused on documentation related to the Army's lodging privatization efforts, including two reports to Congress and an analysis supporting the Army's decision to privatize.<sup>1</sup> Given that Navy, Marine Corps, and Air Force officials identified increased lodging costs as a factor in their decision not to privatize their lodging facilities, we analyzed data for the service-operated lodging facilities for fiscal year 2009 to develop an estimated amount of this increase. We collected data from each military service on the number of authorized temporary duty and permanent change of station travelers and the average daily rate charged for rooms by installation. Complete fiscal year 2009 data were not available for Army installations that were privatized as part of group A because installations were privatized partway through the fiscal year; therefore, we excluded these installations from our analysis. For each installation, we calculated the

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<sup>1</sup>Assistant Secretary of the Army (Installations and Environment), *Privatization of Army Lodging (PAL) Group A Report to Congress* (Washington, D.C.: Mar. 12, 2010) and U.S. Army, *Report to Congress Regarding Management of Army Lodging* (Washington, D.C.: Feb. 25, 2008).

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difference in room rates between the average daily rate and the local per diem rate, as set by the General Services Administration, and multiplied the difference in room rates by the total number of days that authorized travelers stayed in the service-operated lodging facilities. This provided the upper value for the estimate and represents the estimated cost increase if all authorized travelers who stayed in the service-operated lodging in fiscal year 2009 instead chose to stay in a commercial hotel in the local community. We performed the same calculation using 75 percent of the local per diem rate to represent the cost increase if all authorized travelers who stayed in the service-operated lodging in fiscal year 2009 instead chose to stay in the hypothetically privatized lodging facilities on the installation if the military services privatized their lodging facilities using the Army's approach. Additionally, because the military services would save some appropriated funding if they privatized their lodging facilities by not having to operate lodging facilities, we subtracted the amount of appropriated funds that the military services spent directly on their lodging facilities from the estimated cost increases. We obtained this information from financial reports that the military services submit annually to the Office of the Under Secretary of Defense (Personnel and Readiness) to better ensure that the data were comparable across the military services. We have previously reported that the cost data reported by the military services to the Office of the Secretary of Defense annually may not adequately reflect total lodging program costs because determining some appropriated fund support can be difficult. Although we identified problems with the completeness of the cost data based on our review of the data, our previous work on lodging privatization, and interviews with agency officials, we determined that these data were sufficiently reliable for our purposes since this analysis was intended to provide a general estimate of potential increases in lodging expenses under privatization.

To determine the challenges that the Army encountered in privatizing their lodging facilities, we reviewed the Army's Financial Management Operating Guidance for the lodging program, the Army's report to Congress, the Army's Lodging Standards Status Reports, and previous GAO reports on military privatization efforts, including our prior report on lodging privatization and family housing privatization.<sup>2</sup> Additionally, we

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<sup>2</sup>GAO, *Military Housing Privatization: DOD Faces New Challenges Due to Significant Growth at Some Installations and Recent Turmoil in the Financial Markets*, [GAO-09-352](#) (Washington, D.C.: May 15, 2009) and [GAO-07-164](#).

interviewed officials from four installations that were privatized as part of group A—Yuma Proving Ground, Arizona; Fort Leavenworth, Kansas; Fort Sam Houston, Texas; and Fort Myer, Virginia—to provide a range of characteristics that may provide differences in experiences with privatization. Key characteristics we considered in selecting the locations include the amount of revenue generated at the installation during the first 6 months of privatization, percentage of rooms planned to be renovated in the end state of the project, and the amount of funding planned to be spent at the installation in the first phase of the project.

To determine the effect of the economic downturn on the Army's privatization efforts, we reviewed the Army's report to Congress, the Lodging Development and Management Plan completed by the private developer in 2008, and the lease between the Army and the private developer effective in August 2009. Additionally, we interviewed officials from the Office of the Assistant Secretary of the Army (Installations and Environment) and Actus Lend Lease, the private developer for group A to obtain their views about the effect of the economic downturn on the Army's privatization efforts. Additionally, we analyzed changes to the planned room counts to determine changes to the scope of the privatization project by comparing the plans in the Lodging Development and Management Plan to those in the lease between the Army and the private developer.

Finally, to determine the extent to which the Army's report to Congress addresses the required reporting elements in the law, we reviewed the elements in the National Defense Authorization Act for Fiscal Year 2008 and examined whether the Army's report provided the required information. For each of the elements, we reviewed previous GAO reports to identify best practices that allowed us to assess whether additional information could have helped clarify the Army's responses. We met with officials in the Office of the Assistant Secretary of the Army (Installations and Environment), the organization that drafted the report, to better understand the process to develop the report and the issues raised in the report. Additionally, to better understand how the issues raised in the Army's report affected lodging privatization and operations of the privatized facilities, we spoke with officials from the Army's Family Morale, Welfare, and Recreation Command; Office of the Assistant Chief of Staff for Installation Management; four installations that were privatized as part of group A—Yuma Proving Ground, Fort Leavenworth, Fort Sam Houston, and Fort Myer; and a representative from Actus Lend Lease, the private developer for group A.

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We began this performance audit in August 2008; however, we suspended the review in March 2009 because the Army delayed the release of its report until March 2010, at which time we reinstated our review. We completed our review in July 2010. This review was performed in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

# Appendix II: Comments from the Department of Defense



ACQUISITION,  
TECHNOLOGY  
AND LOGISTICS

## OFFICE OF THE UNDER SECRETARY OF DEFENSE

3000 DEFENSE PENTAGON  
WASHINGTON, DC 20301-3000

JUL 23 2010

Mr. Brian J. Lepore  
Director  
Defense Capabilities and Management  
U.S. Government Accountability Office  
441 G Street, NW  
Washington, DC 20548

Dear Mr. Lepore:

This is the Department of Defense response to the GAO draft report, GAO-10-771, "DEFENSE INFRASTRUCTURE: Army's Privatized Lodging Program Could Benefit from More Effective Planning," dated June 10, 2010 (GAO Code 351264).

The DoD appreciates the opportunity to comment on the draft report (enclosed).

Sincerely,

A handwritten signature in black ink, which appears to read "John Conger".

For Dorothy Robyn  
Deputy Under Secretary of Defense  
(Installations and Environment)

Enclosure:  
As stated

GAO DRAFT REPORT DATED JUNE 10, 2010  
GAO-10-771 (GAO CODE 351264)

**“DEFENSE INFRASTRUCTURE: ARMY’S PRIVATIZED LODGING  
PROGRAM COULD BENEFIT FROM MORE EFFECTIVE PLANNING”**

**DEPARTMENT OF DEFENSE COMMENTS  
TO THE GAO RECOMMENDATIONS**

**RECOMMENDATION 1:** The GAO recommends that the Secretary of the Army direct the Assistant Chief of Staff for Installation Management and the Commander, Installation Management Command, working with the Assistant Secretary of the Army (Installations and Environment), to assess the costs and benefits of the Army or a private developer repairing life-safety and critical infrastructure deficiencies at facilities in future groups to be privatized.

**DOD RESPONSE:** Concur. The Army has identified the next eleven installations that will privatize lodging and is assessing compliance of the existing inventory with basic commercial fire and life safety requirements as well as the condition of each facility’s mechanical, electrical, and plumbing infrastructure. The Army will then analyze the costs and benefits of correcting deficiencies itself versus using a private developer. However, the Army notes that correction of any life-safety and critical infrastructure deficiencies is not currently funded in either appropriated or non-appropriated budgets.

**RECOMMENDATION 2:** The GAO recommends that the Secretary of the Army direct the Assistant Secretary of the Army (Installations and Environment), working with the Assistant Chief of Staff for Installation Management and the Commander, Installation Management Command, and other appropriate stakeholders, to develop a single, comprehensive transition plan for future lodging privatization that includes details on key aspects of privatizing.

**DOD RESPONSE:** Concur. The Army will consolidate all plans, policies, procedures, and timelines relating to lodging privatization into a single source document for the ease of the various and disparate stakeholders impacted by privatization.



**RECOMMENDATION 3:** The GAO recommends that the Secretary of the Army direct the Assistant Secretary of the Army (Installations and Environment), the Assistant Chief of Staff for Installation Management, the Commander, Installation Management Command, and other stakeholders to clarify how the Army will incorporate lessons learned into its current and future privatization efforts.

**DOD RESPONSE:** Concur. The Army has already started implementing lessons learned concerning correction of life-safety and critical infrastructure deficiencies, termination of existing service contracts, and communication with affected personnel. The Army is collecting additional feedback from the developer, the hotelier, and other stakeholders and will incorporate its findings into the single, comprehensive plan for future lodging privatization transfers.

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# Appendix III: GAO Contact and Staff Acknowledgments

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## GAO Contact

Brian J. Lepore, (202) 512-4523, leporeb@gao.gov

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## Staff Acknowledgments

In addition to the contact named above, Laura Talbott, Assistant Director; Hilary Benedict; Laura Durland; Amy Frazier; and Kyerion Printup made key contributions to this report.

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# Related GAO Products

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*Military Housing Privatization: DOD Faces New Challenges Due to Significant Growth at Some Locations and Recent Turmoil in the Financial Markets.* [GAO-09-352](#). Washington, D.C.: May 15, 2009.

*Defense Infrastructure: Continuing Challenges in Managing DOD Lodging Programs as Army Moves to Privatize Its Program.* [GAO-07-164](#). Washington, D.C.: December 15, 2006.

*Military Housing: Management Issues Require Attention as the Privatization Program Matures.* [GAO-06-438](#). Washington, D.C.: April 28, 2006.

*Military Housing: Further Improvements Needed in Requirements Determination and Program Review.* [GAO-04-556](#). Washington, D.C.: May 19, 2004.

*Military Housing: Better Reporting Needed on the Status of the Privatization Program and the Costs of Its Consultants.* [GAO-04-111](#). Washington, D.C.: October 9, 2003.

*Military Housing: Management Improvements Needed as the Pace of Privatization Quickens.* [GAO-02-624](#). Washington, D.C.: June 21, 2002.

*Military Housing: DOD Needs to Address Long-Standing Requirements Determination Problems.* [GAO-01-889](#). Washington, D.C.: August 3, 2001.

*Military Housing: Continued Concerns in Implementing the Privatization Initiative.* [GAO/NSIAD-00-71](#). Washington, D.C.: March 30, 2000.

*Military Housing: Privatization Off to a Slow Start and Continued Management Attention Needed.* [GAO/NSIAD-98-178](#). Washington, D.C.: July 17, 1998.

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